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PENNSYLVANIA SUPERIOR COURT CONFIRMS CGL INSURERS OWE NO DUTY TO DEFEND OR INDEMNIFY HOMEBUILDERS AGAINST CONSTRUCTION DEFECT CLAIMS

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On December 28, 2007, Cozen O'Connor attorneys scored another important victory for insurers in Pennsylvania. In a carefully-reasoned, precedential opinion, a panel of the Superior Court unanimously confirmed that an insurer has no duty to defend or indemnify a builder under a CGL policy for water intrusion damage to a home due to faulty workmanship. The 26-page decision in *Millers Capital Insurance Co. v. Gambone Brothers Development Co.,* 2007 PA Super 403, _ A.2d _, affirmed two prior summary judgment rulings by the Montgomery County Court of Common Pleas. This ruling follows on the heels of Cozen O'Connor's landmark victory in Pennsylvania's Supreme Court in *Kvaerner Metals Division of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.,* 908 A.2d 888 (Pa. 2006) ("*Kvaerner*"),where the Court declared that construction defect claims do not constitute "accidents" or "occurrences" for purposes of coverage under CGL policies.

Gambone sought CGL coverage in connection with lawsuits and contractual arbitration demands from over 100 homeowners who claimed extensive mold and water damage to both exterior and interior elements of their home allegedly due to defective construction of the stucco exteriors of their homes by Gambone and/or its subcontractors. Millers Capital filed two declaratory judgment actions: one sought a declaration that it had no obligation to indemnify the Gambone against a $1.1 million arbitration award in favor of four original homeowners; the second asked for a declaration that Millers Capital had no duty to defend or indemnify against a separate lawsuit brought by another homeowner.

In affirming summary judgment for Millers, the Superior Court declared that "damage caused by rainfall that seeps through faulty home exterior work to damage the interior of a home is not a fortuitous event that would trigger [liability] coverage." The panel rejected several attempts by the insured and its allied amicus to distinguish or circumvent the Supreme Court's holding in *Kvaerner*. In so doing, the Court made a number of rulings that are extremely helpful to our insurer clients and are certain to

be quoted by insurers in future cases both in Pennsylvania and around the country where this issue continues to be hotly contested.

Conceding that *Kvaerner* foreclosed its claim for coverage for the costs of repairing the defective stucco itself, Gambone argued for a distinction between damage to the stucco and damage to the interior portions of the homes.. The Court, however, found that *Kvaerner* did not support such a distinction and, indeed, that "the weight of common sense collapses the distinction Gambone attempts to create." Both the complaints against Gambone and *Kvaerner* alleged "that when the defects manifested themselves, water damage resulted to the interior of the larger product – in this case, the home interiors."

The Court further rejected Gambone's argument that periodic rainfall constituted "continuous or repeated exposure to substantially the same general harmful conditions" and therefore constituted an "occurrence." To the contrary, the Court declared that "natural and foreseeable acts, such as rainfall, which tend to exacerbate the damage, effect or consequences caused *ab initio* by faulty workmanship also cannot be considered sufficiently fortuitous to constitute an 'occurrence' or 'accident' for the purposes of an occurrence based CGL policy."

The panel further rejected the insured's efforts to derive coverage on the basis of the amount of policy premiums paid for products-completed operations hazard coverage. Finding no framework to conduct such an inquiry, the Court refused to "step outside the certified record" to determine "whether [Gambone] paid an amount which could lead us to believe it intended to purchase coverage for damages caused by the faulty workmanship of subcontractors."

The Court notably rejected Gambone's efforts to manufacture coverage from exceptions to policy exclusions (arguments that were raised, but not addressed by the Supreme Court, in *Kvaerner*). The Court carefully considered, dissected, and rejected Gambone's argument that the subcontractor exception to the "your work" exclusion created an ambiguity in the policy. The Court rejected Gambone's argument that coverage needed to be found to avoid rendering these provisions "mere surplusage." To the contrary, the Court declared, accepting Gambone's flawed argument instead "would render the definition of 'occurrence' mere surplusage in every instance where a plaintiff sues a contractor for faulty work performed by a subcontractor on the contractor's behalf."

Finally, the Court in no uncertain terms rejected Gambone's efforts to invoke the doctrine of "reasonable expectations" in order to overcome the policy's unambiguous terms, reaffirming that an insured "may not complain that its reasonable expectations have been frustrated when the applicable policy limitations are . . . unambiguous as a matter of plain language and judicial construction." As the Court admonished:

> applying the doctrine in the way for which Gambone and United advocate would undermine the fundamental principles of insurance contract law and impair the Commonwealth insurance industry. If we were to allow an insured to override the plain

> language of a policy limitation anytime he or she was dissatisfied with the limitation by simply invoking the reasonable expectations doctrine, the language of insurance policies would cease to have meaning and, as a consequence, insurers would be unable to project risk. The inability to project risk would dissuade insurers from doing business in the Commonwealth and the net result would be an increase in premiums for consumers. We refuse to set such a deleterious sequence of events into motion.

The Superior Court's decision represents another significant victory for insurers in Pennsylvania. Not only did the Court reaffirm *Kvaerner* as the law of the land, but it also clarified that the limitation on coverage for faulty workmanship applies not only to the faulty work itself, but the natural consequences of faulty workmanship, such as water intrusion, even where damages occurs to other, non-defective components of the insured's overall work product.

Please contact Jacob C. Cohn (jcohn@cozen.com), Michael A. Hamilton (mhamilton@cozen.com), or Joseph A. Arnold (jarnold@cozen.com), in our Philadelphia office (800-523-2900) if you have any questions regarding this Alert.